3rd Quarter 2017 Earnings Conference Call Transcript

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CORPORATE PARTICIPANTS
John Stroup Belden, Inc. - President, CEO, and Chairman
Henk Derksen Belden, Inc. - CFO, SVP-Finance
Kevin Maczka Belden, Inc. – VP of Investor Relations

PRESENTATION

Kevin Maczka Belden, Inc. – VP of Investor Relations

Thank you, operator. Good morning, everyone, and thank you for joining us today for Belden's third quarter 2017 earnings conference call.

My name is Kevin Maczka, I'm Belden's Vice President of Investor Relations. With me this morning are John Stroup, President, CEO, and Chairman, and Henk Derksen, Belden's CFO. John will provide a strategic overview of our business, and then Henk will provide a detailed review of our financial and operating results, followed by Q&A.

We issued our earnings release earlier this morning, and we have prepared a slide presentation that we will reference on this call. The press release, presentation, and transcript of these prepared remarks are currently available online at investor.belden.com.

Turning to slide 2 in the presentation.

During this call management will make certain forward looking statements in reliance upon the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995. For more information, please review today's press release and our annual report on Form 10-K.

Additionally, during today's call management will reference adjusted or non-GAAP financial information. In accordance with Regulation G, the appendix to our presentation and the investor relations section of our Web site contain a reconciliation of the most closely associated GAAP financial information to the non-GAAP financial information we communicate.

I will now turn the call over to our President, CEO, and Chairman, John Stroup. John?

John Stroup Belden, Inc. – President, CEO, and Chairman

Thank you, Kevin, and good morning, everyone.

As a reminder, I'll be referring to adjusted results today.

Please turn to Slide 3 in our presentation for a review of our third quarter highlights.

Overall, the business performed in line with our expectations during the third quarter. We are pleased with our continued EBITDA margin expansion, double-digit EPS growth, and recent debt refinancing.

Total revenues increased 3.2% to a quarterly record $621.7 million, driven by our Industrial and Enterprise Solutions platforms.
EBITDA grew 6.9% year-over-year, from $111.5 million to $119.2 million. EBITDA margins expanded 70 basis points from 18.5% in the prior year period to 19.2%. Our proven Lean enterprise system continues to drive impressive productivity gains.

EPS increased a solid 15.5% in the third quarter, from $1.29 in the prior year period to $1.49.

We were also extremely pleased with the execution of our debt refinancing and repayment during the quarter. By issuing 450 million euros of senior subordinated notes at 3.375% and 300 million euros at 2.875%, the lowest long-term borrowing rates in the history of the company, we have further lowered our cost of capital and extended our maturities. In total, we expect these actions to be accretive to EPS by $0.47 on a full-year basis.

For the full-year 2017, we are increasing the low end of our revenue and EPS guidance. We expect record quarterly revenues and EPS in the fourth quarter.

We are also very well positioned with a number of attractive M&A opportunities.

Please turn to slide 4 for a review of our business segment results.

Broadcast segment revenues in the quarter were $193.8 million, compared to $196.2 million in the year ago period. Thinklogical performed in line with our expectations in the first full quarter of ownership. Our Broadband business, however, had a softer than expected quarter. We estimate that the temporary revenue impact from the hurricanes on our Broadband business was approximately $5 million. This business is now recovering nicely, with strong order growth in October.

Broadcast EBITDA margins were 18.4%, in line with the prior-year period.

Enterprise revenues increased 6.7% to $167.1 million, in line with our expectations, driven by our successful commercial programs and increased pricing. Demand for smart buildings remains healthy, as evidenced by the 67% growth in our Category 6A cable products, which deliver data and power over Ethernet, and 23% growth in our connectivity products.

EBITDA margins declined 160 basis points year-over-year to 15.8%, as the timing of our pricing actions could not fully offset the steadily rising copper costs. We expect our margins to improve in the fourth quarter.

Revenues in our Industrial Solutions platform increased 7.1% to $160.5 million, with continued strength in Discrete Manufacturing, our largest vertical. End market demand was very encouraging in the quarter, with orders increasing 12% organically on a year-over-year basis.

EBITDA margins increased a robust 320 basis points from the year-ago period to 19.0% driven by solid volume leverage and productivity gains.

Network Solutions revenues increased 0.6% from the prior year period to $100.4 million.

EBITDA margins increased 30 basis points year-over-year and 260 basis points sequentially to 24.8%.

I will now ask Henk to provide additional insight into our third quarter financial performance. Henk?

Henk Derksen Belden, Inc. - CFO, SVP-Finance

Thank you, John. I will start my comments with results for the quarter, followed by a review of our segment results, a discussion of the balance sheet, and close with our cash flow performance. As a reminder, I will be referencing adjusted results today.

Please turn to Slide 5 for a detailed consolidated review.

Revenues in the quarter were a record $621.7 million dollars, increasing 3.2% from $602.5 million in the third quarter 2016. Currency translation and higher copper prices increased revenues by $8.1 and $5.1 million dollars, respectively. The acquisition of Thinklogical contributed $11.6 million dollars in the first full quarter of ownership.

After adjusting for these factors, revenues decreased 0.9% organically from the prior-year period.

Sequentially, revenues increased $11.1 million dollars from $610.6 million.

Gross profit for the quarter was $255.4 million, or 41.1% of revenues. Compared to the prior-year period, gross profit increased 2.0%, mainly a result of productivity initiatives.

Sequentially, gross profit increased 1.3% from $252.1 million.

Operating expenses were $149.8 million dollars, or 24.1% of revenues, down $1 million from the prior-year. After adjusting for the impact of currency translation and the acquisition of Thinklogical, operating expenses decreased $4.7 million. This was driven by significant productivity improvements within SG&A, which reduced expenses by $5.6 million year-over-year. R&D expenses increased $0.9 million dollars from prior-year levels, as we continue to invest in innovation.

EBITDA was $119.2 million dollars, or 19.2% of revenues. Compared to the prior-year period, EBITDA increased $7.7 million dollars, or 6.9%. On a sequential basis, EBITDA increased 6.6% from $111.8 million.

Net interest expense of $19.4 million dollars decreased $4.1 million dollars year-over-year and sequentially, driven by the successful execution of our debt refinancing actions in the third quarter.

As a result of these actions, we now expect our interest expense to be approximately $16.9 million in the fourth quarter and approximately $68 million on an annual basis.

The effective tax rate for the third quarter was 16.6%, compared to 19.9% in the prior year. The current quarter benefitted from incremental discrete tax planning initiatives.

For financial modelling purposes, we recommend using a 19% effective tax rate for the fourth quarter, resulting in a tax rate of approximately 18% for the full-year.

Net income in the quarter was $73.9 million dollars, increasing $12.4 million, or 20.2%, from $61.5 million in the prior-year period.

Earnings per share was $1.49 in the quarter, increasing 15.5% from $1.29 in the prior-year period.

Please turn to slide 6. I will now discuss revenues and operating results by business segment.

Our Broadcast Solutions segment generated revenues of $193.8 million dollars in the third quarter. Revenues decreased by 1.2% from $196.2 million in the prior-year period. Currency translation had a favorable impact of $1.2 million dollars, and Thinklogical contributed $11.6 million dollars. On an organic basis, revenues declined 7.3% year-over-year. We estimate that the temporary unfavorable impact from hurricanes in the quarter was $5 million.

Broadcast EBITDA margins were 18.4% in the quarter, decreasing 20 basis points from the prior-year and increasing 270 basis points sequentially.

Our Enterprise Solutions segment generated revenues of $167.1 million dollars during the quarter, increasing 6.7% from the prior-year period. On an organic basis, adjusted for copper and currency translation, revenues increased 3.0% from the prior-year period.

EBITDA margins were 15.8% in the quarter, decreasing 160 basis points from the prior-year, driven by the impact of higher copper prices and the timing of price increases.

The Industrial Solutions segment generated revenues of $160.5 million dollars in the quarter, an increase of 7.1% from $149.8 million in the prior-year period. Currency translation and higher copper prices had a favorable impact of $5.2 million dollars. Adjusting for these factors, and the impact of channel inventory movements, revenues grew 6.3% organically.

EBITDA margins of 19.0% increased 320 basis points year-over-year driven by solid leverage on volume and productivity gains.

Our Network solutions segment generated revenues of $100.4 million dollars, growing 60 basis points from $99.8 million in the prior-year period. Currency translation had a favorable impact of $2.0 million dollars in the quarter.

EBITDA margins of 24.8% increased 30 basis points from the prior-year period and 260 basis points sequentially.

If you will please turn to Slide 7, I will begin with our balance sheet highlights.

Our cash and cash equivalents balance at the end of the third quarter was $461 million dollars compared to $670 million in the second quarter and $748 million in the prior year period. The sequential decrease reflects the debt repayment completed in the quarter, net of cash flow generation.

Working capital turns were 7.1 turns, increasing 0.1 turns from the second quarter and decreasing 1.8 turns year-over-year. The year-over-year decrease is mainly a result of increased inventory levels.

PP&E turnover was 7.7 turns, an improvement of 0.1 turns from the second quarter and 0.3 turns year-over-year.

Our total debt principal at the end of the quarter was $1.55 billion, compared to $1.70 billion in the second quarter and $1.71 billion in the third quarter 2016. The decrease reflects the debt repayment completed in the quarter.

Net leverage was 2.3 times net debt to EBITDA at the end of the third quarter, in-line with the prior quarter and prior year.

We're extremely pleased with our refinancing actions and the quality of our balance sheet. We have lowered our cost of debt significantly from 5.3% to 3.9% and extended our maturities to 2023 and beyond. We have plenty of capacity available to execute upon our strategic plan and we estimate our dry powder to be approximately $475 million.

Please turn to Slide 8 for a few cash flow highlights.

Cash flow from operations in the third quarter was $68.8 million dollars compared to $86.9 million in the prior year.

Net capital expenditures were $11.2 million for the quarter, increasing $500,000 from the prior-year period.

As a result, free cash flow was $57.6 million dollars in the third quarter 2017 compared to $76.2 million in the prior year period.

Year-to-date, we have generated cash flow from operations of $103.6 million and free cash flow of $70.2 million dollars. Compared to the prior-year, free cash flow is $41.5 million lower due primarily to three factors impacting our inventory levels.

First, copper inflation has increased the value of our inventory by approximately $20 million. Secondly, we are holding $10 million in additional inventory as we anticipate customer demand to quickly rebound following the recent hurricanes. Finally, as we approach the final milestone of our manufacturing footprint consolidation, we are holding a higher level of safety stock for a temporary period, with an approximate impact of $5 million.

In addition, we are now planning to increase our commitment to growth initiatives and will increase capital expenditure by approximately $10 million, including a new investment in manufacturing capacity in India.

As a result, we expect free cash flow of $225 million for the full-year 2017.

We are pleased with the disciplined capital allocation actions completed in 2017. Year-to-date, we have allocated $167 million towards acquisitions and returned $44 million to shareholders through dividends and share repurchases.

When combined with our recent refinancing, we anticipate these actions to be accretive to EPS by $0.76 on a full-year basis.

That completes my prepared remarks. I would now like to turn this call back to our President, CEO, and Chairman, John Stroup, for the outlook. John?

John Stroup Belden, Inc. – President, CEO, and Chairman

Thank you, Henk.

Please turn to Slide 9 for our outlook regarding the fourth quarter and full-year 2017 results.

Our consolidated results for the third quarter were in line with our expectations, and we are increasing the low end of our full-year revenue and EPS guidance. We expect record quarterly revenues, EBITDA margins, and EPS in the fourth quarter.

Further, we continue to actively pursue a number of attractive inorganic opportunities.

We anticipate fourth quarter 2017 revenues to be between $641 and $661 million, and EPS of $1.71 to $1.81.

For the full year 2017, we expect revenues between $2.425 and $2.445 billion, relative to our prior guidance of between $2.415 and $2.445 billion. We now expect full year EPS of $5.45 to $5.55 compared to our prior guidance of $5.35 to $5.55.

We look forward to providing 2018 guidance and further insights into the business during our Investor Day webcast on December 5th. Details can be found at investor.belden.com.

That concludes our prepared remarks, operator please open the call to questions.